SUMMARY ANALYSIS OF AMENDED BILL

Franchise Tax Board

Author: Nation | Analyst: Kimberly Pantoja | Bill Number: AB 26

Related Bills: See Prior Analysis | Telephone: 845-4786 | Amended Date: 03/27/01

Attorney: Patrick Kusiak | Sponsor: ______

SUBJECT: Scholarshare Trust Credit/FTB Report To Legislature Annually Regarding Utilization of Credit

____ DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as introduced/amended ______________.

X AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided.

X AMENDMENTS DID NOT RESOLVE ALL THE DEPARTMENT'S CONCERNS stated in the previous analysis of bill as introduced December 4, 2000.

X FURTHER AMENDMENTS NECESSARY.

____ DEPARTMENT POSITION CHANGED TO ______________.

X REMAINDER OF PREVIOUS ANALYSIS OF BILL AS INTRODUCED December 4, 2000, STILL APPLIES.

____ OTHER - See comments below.

SUMMARY

This bill would establish a tax credit of up to $500 for contributions to Scholarshare accounts.

SUMMARY OF AMENDMENT

The March 27, 2001, amendments would allow contributions to qualified state tuition programs in other states to also qualify for the credit.

The amendments would delete the refundable portion of the bill and add a provision allowing the credit to be carried over indefinitely when the amount of the credit exceeds the taxpayer's tax liability.

The March 27, 2001, amendments resolved the department's implementation and policy concerns by eliminating the refundable provision in the bill; however the amendments also raise additional implementation considerations. Except for the considerations resolved by these amendments, the remainder of the department's analysis of the bill as introduced still applies. The remaining technical considerations and the new implementation considerations have been included below.

POSITION

Pending.

Board Position:

____ S ____ NA ____ NP
____ SA ____ O ____ NAR
____ N ____ OUA X PENDING

Legislative Director: Brian Putler | Date: 04/10/01

Summary of Suggested Amendments

Department staff is available to assist with amendments to resolve the concerns discussed in this analysis.

IMPLEMENTATION CONCERNS

The department does not have any program or other information to verify the annual contributions and earnings of qualified state education savings or tuition programs from other states, making the credit difficult to verify or audit.

The bill specifies that the amount of the credit may not exceed $500 per beneficiary. It is unclear if multiple taxpayers could claim the credit for the same beneficiary (e.g., parent and grandparent each claim a $500 credit for the same beneficiary). Clarification on this issue is needed.

This bill does not limit the number of years for the carryover period. The department would thus be required to retain the carryover on the tax forms indefinitely because an unlimited credit carryover period is allowed. Recent credits have been enacted with a carryover period limitation since experience shows credits typically are exhausted within eight years of being earned.

TECHNICAL CONSIDERATIONS

The bill uses both the term “individual” and “taxpayer” in the same subdivision. For simplicity, Amendment 1 has been provided so that only the term “individual” is used.

The bill refers to the Education Code for definitions of certain terms, such as “beneficiary” and “qualified higher education expenses.” The Education Code, in turn, defines these terms by reference to provisions of Section 529 of the Internal Revenue Code (IRC), as amended in 1997 by P.L. 105-34. IRC Section 529, as amended in 1997, is also applicable for California tax purposes. However, IRC Section 529 with respect to the definition of “qualified higher education expenses” was amended in 2000. Although this change is not yet applicable for California tax purposes, legislation is routinely introduced and considered to conform California tax law to recently enacted changes to the IRC. Other California laws, such as the Education Code, that refer to the IRC are not affected by any general federal conformity legislation. Amendments 2 and 3 are provided as a direct reference to provisions of federal law to be consistent with other provisions of the Revenue and Taxation Code and provide a more effective means of clearly conforming with federal changes.

OTHER STATES’ INFORMATION

Review of Michigan and New York laws found similar tax credits for educational savings. These states were reviewed because of the similarities between California income tax laws and their tax laws.

Michigan - The Michigan Education Savings Program allows parents, grandparents, relatives or friends to contribute to an account to save for a child's higher education. There are no state income taxes on earnings used to pay for qualified higher education expenses, and account owners can receive an annual state income tax deduction of up to $5,000 or $10,000 for joint filers. There also is a state matching contribution of one dollar for every three dollars contributed by a first-time account owner, up to a maximum state contribution of $200, with a family income eligibility ceiling of $80,000 and a beneficiary age limit of six.

New York - The College Choice Tuition Savings Program provides a tax incentive for saving for post-secondary education by allowing account owners to deduct up to $5,000 ($10,000 for joint filers) for contributions to all family tuition accounts. The investment earnings on the account are deferred for both federal and state income tax purposes while held in the account. When a withdrawal is made for purposes of paying higher education expenses, the investment earnings are taxable to the beneficiary for federal purposes, but are exempt for New York State purposes.

FISCAL IMPACT

Due to the elimination of the refundable provision, this bill is not expected to impact the department's costs significantly.

ECONOMIC IMPACT

Revenue Estimate

Based on limited data and assumptions discussed below, the bill as amended would result in the following revenue losses under the Personal Income Tax Law.

Estimated Revenue Impact of AB 26 As Amended March 27, 2001 [$ In Millions]		
2001-02	2002-03	2003-04
-$4	-$8	-$13

Except for specific adjusted gross income classes and credit percentages, it is assumed other credit limitations apply on a per beneficiary basis.

Revenue Discussion

The revenue impact of this bill would be determined by the amount of credits that could be applied to reduce tax liabilities.

Potential revenue losses are reduced somewhat from the bill's impact as introduced. Reduced revenue losses are due to the elimination of the refundable provisions since the amount of applied credits in any given taxable year are expected to be somewhat less than the total credits generated in each taxable year. Allowing contributions to any qualified state education savings or tuition program in addition to a Scholarshare trust would have a negligible revenue effect.

LEGISLATIVE STAFF CONTACT

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FRANCHISE TAX BOARD’S
PROPOSED AMENDMENTS TO AB 26
As Amended March 27, 2001

AMENDMENT 1

On page 2, line 7, strike "a taxpayer" and insert:

that individual

AMENDMENT 2

On page 3, strike lines 9 through 11 and insert:

(c) For purposes of this section, "qualified beneficiary" has the same meaning as the term "designated beneficiary" under paragraph (1) of subsection (e) of Section 529 of the Internal Revenue Code.

AMENDMENT 3

On page 3, strike 31 and 32 and insert:

qualified higher education expenses as defined in paragraph (3) of subsection (e) of Section 529 of the Internal Revenue Code.